United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

76-5025, 76-5033-5037

To be Argued by
WHITNEY NORTH SEYMOUR

IN THE

United States Court of Appeals

For the Second Circuit

In Proceedings for the Reorganization of a Railroad under Section 77 of the Bankruptcy Act

IN THE MATTER OF THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, DEBTOR

LAWRENCE W. IANNOTTI, Successor Indenture Trustee Under The New York, New Haven And Hartford Railroad Company's First And Refunding Mortgage Dated As Of July 1, 1947; and

JACOB D. ZELDES, Successor Indenture Trustee Under The New York, New Haven And Hartford Railroad Company's General Income Mortgage Dated As of July 1, 1947,

Appellants,

MANUFACTURERS HANOVER TRUST COMPANY, Former Indenture Trustee Under The New York, New Haven And Hartford Railroad Company's First And Refunding Mortgage Dated As Of July 1, 1947; and

RICHARD JOYCE SMITH, Trustee Of The Property Of The New York, New Haven And Hartford Railroad Company, Debtor,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT, HONORABLE ROBERT P. ANDERSON, CIRCUIT JUDGE, SITTING BY DESIGNATION

ANSWERING BRIEF OF APPELLEE MANUFACTURERS HANOVER TRUST COMPANY

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ANSWERING BRIEF OF APPELLEE MANUFACTURERS HANOVER TRUST COMPANY

Question Presented

Whether in the exercise of its discretion the Reorganization Court as a court of equity properly determined the compensation to be awarded pursuant to Section 77(c)(12) of the Bankruptcy Act to Manufacturers Hanover Trust Company, as Indenture Trustee, including compensation of Simpson Thacher & Bartlett as its counsel?

Statutes Primarily Involved

Section 77(c)(12) of the Bankruptcy Act, 11 U.S.C. § 205(c)(12)[1] provides:

> ". . . the judge may make an allowance, to be paid out of the debtor's estate, for the actual and reasonable expenses (including reasonable attorney's fees) incurred in connection with the proceedings and plan by parties in interest and by reorganization managers and committees or other representatives of creditors and stockholders, and . . . may make an allowance to be paid out of the debtor's estate for the actual and reasonable expenses incurred in connection with the proceedings and plan and reasonable compensation for services in connection therewith by trustees under indentures, depositories and such assistants as the Commission with the approval of the judge may especially employ. . . ."

Counter-Statement of the Case

The principal events which are central to this appeal occurred before either of the Appellants became involved

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[1] As effectively amended, so far as here pertinent, by Section 618(b)(4) of the Railroad Revitalization and Regulatory Reform Act of 1976, P.L. 94-210 (*4RA*).

in this case. To avoid confusion, we narrate the relevant facts chronologically, noting the material errors in Appellants' brief.

Events Prior to the Penn-Central Bankruptcy

On July 7, 1961 The New York, New Haven and Hartford Railroad Company (New Haven) filed for reorganization under Section 77 of the Bankruptcy Act, 11 U.S.C. § 205 (Section 77). At that time Manufacturers Trust Company was, and had been since 1947, Corporate Indenture Trustee of the New Haven First and Refunding Mortgage (First Mortgage).[2] Manufacturers intervened in the New Haven reorganization through its general counsel, Simpson Thacher & Bartlett (ST&B), which had represented it as Corporate Trustee since 1947. Judge Anderson has been in charge of this reorganization and related matters since their beginnings in July 1961.

In 1962 the Pennsylvania Railroad and the New York Central Railroad first proposed the merger which ultimately led to the creation of the Penn-Central in February 1968.[3] As a result of the intervention by the New Haven Reorganization Trustees, primarily under Section 5(2) of the Interstate Commerce Act, 49 U.S.C. § 5(2), an Inclusion Agreement was reached and executed in early 1966, between the Reorganization Trustees and the Penn-Central, to the effect that after the proposed merger Penn-Central would acquire the bulk of the New Haven assets for consideration

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[2] There was also an individual trustee, A. Frederick Keuthen, an officer of the Corporate Trustee. In September 1961, Manufacturers Trust Company merged with The Hanover Bank forming Manufacturers Hanover Trust Company (Manufacturers).

[3] We shall hereafter ordinarily refer to "Penn-Central" as meaning both the merged railroad and its major constituents; where necessary, we shall refer to the New York Central Railroad Company as the "Central".

consisting of cash, bonds and Penn-Central stock, plus the assumption of certain New Haven obligations. By the terms of the Inclusion Agreement, the New Haven Reorganization Trustees bound themselves to support it as fair.

With the Reorganization Trustees precluded from challenging the adequacy of this consideration, an unusual situation was created in which the burden of attacking it fell, until 1969, upon the representatives of the New Haven bondholders, including Manufacturers as Corporate Trustee under the First Mortgage.

The Inclusion Agreement was filed with the Interstate Commerce Commission (ICC) in late 1966 as part of a two-fold proceeding (relating first to the Penn-Central merger and second to the New Haven reorganization) of almost unprecedented intricacy.[4] These proceedings before the courts and the ICC, which presented numerous questions of first impression, finally resulted in (1) authorization of the Penn-Central merger conditioned upon the purchase of the New Haven assets; (2) the transfer of those assets to Penn-Central on December 31, 1968 upon payment of certain consideration, subject to a reservation of jurisdiction to determine later the ultimate amount and form of payment for those assets; and (3) on June 29, 1970, the decision of the Supreme Court of the United States in the *New Haven Inclusion Cases*, 399 U.S. 392, that the consideration paid by Penn-Central was grossly

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[4] In this connection, see the comments of the Reorganization Court, *In re New York, New Haven and Hartford Railroad Co.*, 304 F.Supp. 1121, at 1126-27. Ultimately involved were separate ICC hearings, two review proceedings in the South[illegible]istrict of New York before a three-judge court together with [illegible]ompanion reviews before the Reorganization Court, and ancillary proceedings before both the Southern District of New York and the Reorganization Court, culminating in the Supreme Court's decision described below.

inadequate.[5] The Court specifically referred to the fact that Penn-Central itself had petitioned for reorganization on June 21, 1970. 399 U.S. at 399.

Events After the Penn-Central Bankruptcy

The Hanover Bank (Hanover) had served as a trustee under Central mortgages since 1897 (A376).[6] When Hanover merged into Manufacturers Trust Company in September 1961, the merged bank succeeded as corporate trustee to the Central mortgages administered by Hanover. Manufacturers' corporate trust department was generally represented by Hanover's traditional counsel, then known as Kelley Drye Newhall Maginnes & Warren (Kelley Drye). Their assignment involved continuing responsibility with respect to Hanover's Central mortgage trusteeships. Because it had been involved since 1947, ST&B was asked to continue to represent Manufacturers with respect to the New Haven trusteeship.[7]

On July 1, 1970, Manufacturers concluded that, as a result of the Penn-Central bankruptcy on June 21, 1970, there were potential conflicts between its role as Corporate Trustee of the New Haven First Mortgage and its status as a creditor of Penn-Central and its trusteeships under the Central mort-

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[5] The *New Haven Inclusion Cases* were heard by the Supreme Court on appeal from a decision of a statutory three-judge court (upholding the ICC's much lower award), *New York, N.H.&H.R. Co., 1st Mtg. 4% B.C.* v. *United States,* 305 F.Supp. 1049 (S.D.N.Y. 1969), and by certiorari from a decision of the Reorganization Court, rejecting the ICC's award, *In re New York, New Haven and Hartford Railroad Co.,* 304 F.Supp. 793 and 1136. Manufacturers and ST&B had been deeply involved in all of the proceedings below and took a leading role in briefing and argument before the Supreme Court.

[6] Citations to the Joint Supplemental Appendix are indicated by "A ".

[7] Appellants suggest (App. Brief, pp. 3, 31) that Manufacturers "hired" separate counsel for the New Haven and the Penn-Central reorganization proceedings. The facts are as set forth above.

gages. (A220, A349). Commencing July 1, 1970 Manufacturers, through its counsel, (a) advised the New Haven Reorganization Court, the New Haven Reorganization Trustees and their counsel, as well as counsel for the General Income Mortgage and for the First Mortgage Bondholders Committee, of these potential conflicts, and that it therefore proposed to seek a qualified successor and to resign its New Haven trusteeship (A220-221), and (b) informed the Penn-Central reorganization court, in connection with its petition to intervene in the Penn-Central reorganization proceedings, that Manufacturers had potential conflicts of interest there because, among other things, of its New Haven trusteeship (A352-353).[8] In the papers supporting its intervention petition before the Penn-Central reorganization court, Manufacturers' counsel, Kelley Drye, described precisely the problem it faced:

> "However the situation came about, we and Manufacturers have decided, I believe correctly, that its duty to the bondholders under these mortgages requires us to intervene in this proceeding as soon as we can, rather than leaving them unrepresented until (and if) separate trustees and counsel, unconnected with this reorganization, can be found for each trust." (A351)

This contemporaneous memorandum of Kelley Drye identified the precise analysis on which Manufacturers acted in 1970, namely, that it had no choice, given its fiduciary duties, except to do all that it could to protect the interests of all its *cestuis*. Cf. A383.

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[8] Appellants' assertion (App. Brief, pp. 11, 29) that Manufacturers failed to apprise the relevant courts of the facts that it thought might engender conflict or to take steps to resign until July 1971 is incorrect.

Beginning in July 1970, Manufacturers commenced a comprehensive effort to find successor corporate trustees for both the New Haven First Mortgage and the 18 Central mortgages under which it acted. That search continued into the spring of 1971. Manufacturers endeavored to contact each commercial bank east of the Mississippi that was not known to have a conflict and that was understood to have a significant trust department, at least 62 banks in all. (A383-384; A105-109). No one has suggested that this search was neither comprehensively conducted nor diligently pursued. Indeed, the Reorganization Trustees themselves sought a qualified successor trustee (A510). In this regard, the Reorganization Court stated:

> "Although the Manufacturers Hanover, in apparent good faith, sought to resign from all of its [Central and New Haven trusteeships] and at the same time went to extraordinary lengths throughout the eastern United States to get qualified corporate banks to agree to act as successor indenture trustees, *it was unable to do so. . . . The New Haven reorganization court ran into the same problem when, by the most diligent and thorough searches and inquiries by the Manufacturers Hanover Trust Company, Simpson Thacher & Bartlett, its counsel, and the New Haven reorganization trustee(s) and their counsel no bank could be found to act as successor trustee for the New Haven's first and refunding mortgage bonds.*" (Emphasis added.) (A510).

When the search for successor corporate trustees was proving unsuccessful, the suggestion was made—and ultimately adopted—that the Reorganization Court might ap-

point an individual successor trustee for the New Haven First Mortgage (A510-511).[9]

Manufacturers' efforts to resign its Central trusteeships were even less successful, for reasons which the Reorganization Court recognized and detailed:

> "This is not to suggest that a similar course should have been followed in the cases of the remaining 17 New York Central and/or Pennsylvania Railroad bond issues. *For what it is worth, it is the opinion of this court that, considering the size and complexity of the Penn Central reorganization, such an arrangement would probably be entirely impractical.* It is also understandable that those carrying on the reorganization proceedings of the Penn Central would probably not rise to their feet with unanimous outbursts of enthusiasm to see 17 new successor trustees with 17 new counsel enter the ballpark." (Emphasis added) (A511).

The Reorganization Court's Order of August 10, 1970

On August 10, 1970, barely six weeks after the commencement of the largest reorganization in the history of the United States and while Manufacturers' efforts to resign were under way, the New Haven Reorganization

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[9] This made it feasible for Manufacturers to file on June 22, 1971 a formal application to resign (A4; A93-99), which the Court approved without opposition on July 29, 1971, appointing Lawrence W. Iannotti, one of the Appellants herein, as successor (A4; A115-117). Manufacturers filed this application after the Reorganization Court decided the equitable lien-constructive trust question (discussed below) which had been in litigation before that Court from August 10, 1970 until its decision was filed on June 11, 1971 (A95). Manufacturers thereupon filed its accounts, which were approved without objection, in February 1972 (A130-131).

Court directed that "all parties to [the *New Haven Inclusion Cases*], and all other persons who satisfy this Court that they have an interest in the proceedings . . ." (A9), file written statements of position by August 24, 1970, and further directed that a hearing be held on August 25, 1970, on a number of questions having to do with the content of its order remanding the *New Haven Inclusion Cases* to the ICC (A9-12). This order raised the question whether, in order to carry out the Supreme Court's mandate directing that the New Haven receive the fair value of the assets it conveyed, it was necessary to secure the balance of approximately $130 million due under that decision by imposing an equitable lien and constructive trust on the assets the New Haven transferred to Penn-Central on December 31, 1968.

On the New Haven side, the Reorganization Trustee, supported by the New Haven creditor interests, including Manufacturers as Trustee of the First Mortgage, urged imposition of an equitable lien and constructive trust. Manufacturers' briefs were filed in November 1970 and January 1971 (A36-53; A54-57; A58-92). (For briefs of other New Haven fiduciaries, see Docket Nos. 3166, 3176, 3181, 3183, 3212, 3213 and 3215). As Trustee of the Central's Gold Bond Mortgage, Manufacturers, through its counsel, Kelley Drye, filed a statement of position (A28-35) asserting that the New Haven Reorganization Court lacked jurisdiction to (and therefore could not) order an equitable lien on the physical assets transferred by the New Haven or a constructive trust on the New Haven's share of the excess income from the Grand Central Terminal properties, or in any other way encumber the assets conveyed to Penn-Central, but should defer to the Penn-Central

reorganization court (A30-35).[10] The Penn-Central reorganization trustees took a similar position. (Docket No. 3205).

On June 11, 1971, the Reorganization Court filed its decision, imposing a constructive trust and an equitable lien upon the property which the New Haven had transferred to Penn-Central, to secure payment of the amount adjudged due under the Supreme Court's decision in the *New Haven Inclusion Cases*. On June 22, 1971, Manufacturers and Mr. Keuthen filed their application to resign as Indenture Trustees under the New Haven First Mortgage, which was granted on July 29, 1971.

It is completely inaccurate to claim, as Appellants do (App. Brief, p. 10), that "Manufacturers was on both sides" of the appeal to this Court in *In re New York, New Haven and Hartford Railroad Co.*, 457 F.2d 683 (2d Cir.), *cert. denied*, 409 U.S. 890 (1972). Manufacturers had resigned its New Haven trusteeship before those appeals were filed in this Court. (See this Court's Docket Nos. 71-1903, 71-1929, 71-2024.) The records of that case will show that the only participation by Manufacturers, as Trustee of the Central Gold Bond Mortgage, was a short summary brief concurring in the substantive positions urged by Penn-Central's reorganization trustees.[11]

The principal representatives of the New Haven interests on the appeal, as they had been in the hearing before Judge Anderson, were counsel for the New Haven Reorganization Trustee; supporting them were counsel for the First Mortgage Bondholders Committee, counsel for The Chase Manhattan Bank, N.A., and Mr. Iannotti's firm, which had re-

[10] This is the only paper filed in this proceeding for Manufacturers on behalf of its Central *cestuis* prior to Manufacturers' resignation from the New Haven First Mortgage.

[11] Manufacturers took a similar role in the petitions for certiorari.

placed ST&B when Manufacturers resigned, as counsel for the New Haven First Mortgage. The principal representatives of the Penn-Central interests were Covington & Burling, counsel to the Penn-Central reorganization trustees. Supporting them were counsel for the Penn-Central Transportation Company and Kelley Drye, as counsel for Manufacturers, as Trustee of the Central Gold Bond Mortgage.

The central focus of the appeal was the very issue that had been central in the proceeding below, namely, whether or not there should be an equitable lien and constructive trust imposed on the former properties of the New Haven. The only questions involved were questions of law, principally, the meaning and effect of the Reorganization Court's Order of December 24, 1968 under which the New Haven assets were transferred to Penn-Central; the meaning and effect of the decision of the United States Supreme Court in the *New Haven Inclusion Cases;* and the scope of the jurisdiction of the New Haven Reorganization Court over property which was in the hands of Penn-Central. All of these questions were handled exclusively by counsel.

In its decision of March 17, 1972 in *In re New York, New Haven and Hartford Railroad Co., supra,* this Court held that the New Haven Reorganization Court lacked jurisdiction to impose an equitable lien and constructive trust. The Supreme Court denied certiorari. 409 U.S. 890.

Application for Allowances and Compensation of Expenses Under Section 77(c)(12) of the Bankruptcy Act

On June 16, 1975, Manufacturers and several other bondholder representatives filed with the Reorganization Court applications for compensation for services rendered and reimbursement of expenses, including fees of their counsel, from the beginning of the New Haven Reorganiza-

tion, together with an application for an immediate cash advance thereon.[12] The Reorganization Court, following the then statutory procedure for Section 77(c)(12) applications, referred the applications to the ICC with a request that it act promptly. When, as a result of the enactment of the *4RA* on February 5, 1976, the ICC's prior jurisdiction over Section 77(c)(12) applications relating to the New Haven terminated, these fee applications were deemed refiled with the Reorganization Court.

Hearings on the application of Manufacturers and certain other bondholder representatives were set for May 18, 1976. Prior to the return date, the New Haven Reorganization Trustee filed his statement of position in which he noted, among other things, that in his view there was a conflict of interest issue involving Manufacturers. After summarizing the law and the facts, the Trustee stated his position that it was for the Court to determine what legal effect it should give to Manufacturers' conduct, but added that the Court should consider that, as a practical matter, a reduction of reimbursement for legal fees would have an impact on Manufacturers' counsel who had benefitted the estate and as to whom no misconduct had been intimated. (A300).

Neither of the Appellants here filed any statement of position prior to the May 18, 1976 hearing. At the May 18 hearing, in Mr. Iannotti's absence, Mr. Zeldes orally presented Mr. Iannotti's position which fully endorsed the

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[12] ST&B and Manufacturers' senior management had agreed, in view of Section 77 of the Bankruptcy Act, that ST&B would be legally entitled to compensation only in an amount determined by the courts to be reasonably and properly reimbursable to Manufacturers out of the assets of the New Haven, but ST&B stated that should it feel such amount was grossly inadequate, it would request additional compensation from Manufacturers' own funds. Manufacturers agreed to consider any such request, but it was understood that it would be under no legal obligation to comply. (A138, 167).

position of the New Haven Reorganization Trustee (A425). Mr. Zeldes then stated a position which is substantially consistent with his contentions here (A426-432) and thereafter briefed those views (A443-465). Mr. Iannotti did not join in that subsequent brief.

The Opinion, Order and Judgment Appealed From

On June 30, 1976, the Reorganization Court filed its opinion, order and judgment with respect to the various applications that had been made pursuant to Section 77(c)(12) of the Bankruptcy Act (A486-533). In its opinion and order, the Reorganization Court found that the services rendered by Manufacturers and its counsel had been of significant value to the New Haven and its reorganization, allowed $103,018.34 as reimbursement for the out-of-pocket expenses of Manufacturers, allowed Manufacturers' application for compensation in the full amount applied for ($304,416.67), but directed that payment of such compensation be made contingent by being limited to ¼ of 1% of the amount thereafter recovered by the New Haven from Penn-Central in respect of the assets transferred on December 31, 1968. The Court awarded an additional $808,000 as compensation for the services ST&B had rendered during the course of the reorganization (together with $15,234.81 as reimbursement for ST&B's expenses) and also allowed ST&B an additional contingent fee (A531-532).[13]

The Reorganization Court stated that it had made its award of allowances to Manufacturers contingent upon future recoveries from Penn-Central because it found that

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[13] The overwhelming bulk of the work for which compensation was awarded to ST&B was performed prior to June 1970, the earliest date when any possible conflicting interest of Manufacturers could have been deemed to occur. (A172-267). The relatively modest services performed by ST&B after June 1970 are described at A267-269.

from and after June 1970 (when Penn-Central filed under Section 77), Manufacturers had a conflict of interest since it was acting as indenture trustee under Central mortgages as well as under the New Haven First Mortgage (A515).

While various appeals were filed[14] from the order and judgment of the Reorganization Court dated June 30, 1976, the only remaining appeals are the cross-appeals of Lawrence W. Iannotti and Jacob D. Zeldes, as successor trustees, respectively, of the New Haven's First Mortgage and its General Income Mortgage.

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[14] Although Manufacturers noticed an appeal on July 29, 1976, it moved at the same time for clarification of the Reorganization Court's June 30, 1976 opinion in order to correct any inference that might be drawn to the effect that the Reorganization Court had made any determination with respect to liability or damages having estoppel or *res judicata* effect in any subsequent proceedings that might be commenced against Manufacturers.

The Reorganization Court resolved this uncertainty to Manufacturers' satisfaction in its Clarifying Opinion dated August 20, 1976, in which Judge Anderson reiterated that his finding of a breach related solely to the questions of Manufacturers' compensation and reimbursement of its expenses and was not intended as a bar to any defense Manufacturers might raise in any future action (A575-577).

Therefore the only remaining aspect of the judgment which Manufacturers perceived as adverse was the decision that the award of compensation for services, limited to approximately $305,000, would be contingent upon future recovery by the New Haven from the Penn-Central for its transferred assets. This was not deemed significant enough to warrant pursuing an appeal attacking the exercise of the discretion of the Reorganization Court Judge who had supervised this matter from its beginnings in 1961 although that decision left unchallenged a statement of the Reorganization Court with which Manufacturers profoundly disagrees, namely, that there was a breach of fiduciary duty by Manufacturers after June 1970.

ARGUMENT

The Reorganization Court Did Not Act In Excess of its Powers as a Court of Equity or Abuse its Discretion in Awarding Compensation and Reimbursement to Manufacturers and its Counsel, Simpson Thacher & Bartlett, for Services Rendered and Expenses Incurred by Them.

Introduction

Appellants contend that in a case where a reorganization court, particularly qualified to exercise discretion by virtue of long, direct exposure to the entire course of a reorganization, finds a conflict of interest, it is *bound* to deny all compensation to a fiduciary, regardless of the undisputed benefits to the debtor's estate which have been brought about by the fiduciary's actions, regardless of the nature and character of the conflict found and regardless of whether any damage resulted to the estate from the conflict found. We respectfully submit that this is a result which the court below has properly rejected and which should be rejected here.

To support this proposition, Appellants seek to have imported into this Section 77 proceeding the absolute statutory forfeiture imposed by Congress in cases of self-dealing by bankruptcy fiduciaries under Section 249 of the Bankruptcy Act, 11 U.S.C. § 649, a contention for which we further submit there is no support in law or in equity.

Manufacturers' Actions Were Required to Protect the Interests of Its *Cestuis*

This appeal involves a trustee and its counsel who for ten years rendered indisputably valuable services in a reorganization of theretofore unparalleled dimensions, whose efforts, with those of others, have attained for the Debtor's estate a judgment awarding the New Haven at least $50 million more for the assets it transferred than

the payment to which its own reorganization trustees had agreed. The technical conflict of interest identified by the Reorganization Court arose out of an unprecedented sequence of events which involved no self-dealing or concealment from any of the parties or courts concerned and, we respectfully submit, was created by a necessity beyond the control of anyone.

To avoid any confusion as to Manufacturers' position, it is that nothing that it did amounted to a breach of trust; rather it acted in scrupulous observance of the fundamental obligation of a trustee to protect every one of its *cestuis*. In short there was no breach of duty because there was no choice for Manufacturers but to do what it did.

Counsel for Appellants predict that had Manufacturers sought instructions from Judge Anderson in 1970, it would have been told to quit both the New Haven Trusteeship and the Penn-Central Trusteeships (App. Brief, p. 31). This is obviously sheer speculation. Judge Anderson expressly recognized that he had no power to act with respect to the Penn-Central trusteeships (A388). The fact is that Judge Anderson was told of the conflict in July 1970 and did not indicate any disagreement with Manufacturers' view of its situation, namely, that it should resign as soon as it could find a qualified replacement (A220-221). Similarly, the Penn-Central reorganization court and the Penn-Central reorganization trustees, were aware of the conflict in the summer of 1970 and the Penn-Central reorganization trustees opposed Manufacturers' resignation because it would complicate the reorganization (A353, 384-385; cf. A511).

There is no serious suggestion that any of the acts of Manufacturers after June 21, 1970 were covert nor is there any suggestion of any self-dealing or self-aggrandizement

on the part of Manufacturers by having conducted itself as it did. (Cf. A513).

The facts relating to Manufacturers' conduct after June 21, 1970 are fully set forth in the Counter-Statement of the Case (at pp. 5-11, *supra*). As seems obvious, to the extent that there was any alleged conflict in that period, it was a conflict in legal positions taken by counsel in papers filed with the New Haven Reorganization Court, which ultimately decided in favor of the position of the New Haven representatives.[15]

This was not a fight between Manufacturers and Manufacturers, as Appellants would have it. It was a fight between the New Haven interests (which sought an equitable lien and constructive trust and supported the jurisdiction of the New Haven Reorganization Court) and the Penn-Central interests (which opposed the equitable lien and constructive trust and opposed the New Haven Court's jurisdiction). Each position was upheld by well qualified and capable counsel. The fight was in the open; it was waged through filed briefs and at public hearings before the courts.

By its decision in *In re New York, New Haven and Hartford Railroad Co.*, 457 F.2d 683, *cert. denied*, 409 U.S. 890, that the New Haven Reorganization Court lacked jurisdiction to impose an equitable lien and constructive trust, this Court made a judicial determination of the controversy that began on August 10, 1970. It is, we submit,

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[15] While much is made in Appellants' brief (App. Brief, pp. 35-36) of the role that was played or might have been played by the senior management of Manufacturers in directing and controlling the positions Manufacturers then took through its counsel, on behalf of its New Haven bondholders and on behalf of its Central bondholders, Manufacturers' control consisted simply of authorizing its counsel for each interest to fight as hard as they could for the position of their *cestuis* (A419).

improper to attempt to assign to any party responsibility for that judicial determination. It is likewise improper to speak of harm or injury which may have resulted to anyone from that determination. Any such claim, predicated, as it must be, on the judicial action of this Court, is completely specious and must be rejected.

Appellants' "Continuing Conflict of Interest" Theory is Incorrect

Appellants' analysis of the conflict issue starts with the proposition that there is a conflict of interest *now* existing between Manufacturers and the New Haven Estate, in short that Manufacturers' resignation on July 29, 1971 as Corporate Trustee of the New Haven First Mortgage was not enough to terminate the conflict. The importance of this "continuing conflict" theory to Appellants' analysis is readily apparent from the summary of their position in the first paragraph of their argument (App. Brief, p. 17) and at the bottom of page 18 thereof.[16]

The import of Appellants' position is that, upon the bankruptcy of Penn-Central, an action over which, of

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[16] Appellants suggest (App. Brief, p. 31) that Manufacturers should have filed formal applications for instructions as to whether or not it should resign. This misses the point that Manufacturers' actions made it abundantly clear that it was aware of its obligations and had so informed the courts and the parties. Appellants ignore the fact that Manufacturers was also saying to the courts that it had to find qualified replacements before it could resign.

Appellants also make much of the "insulation" theory (App. Brief at pp. 11, 31-34), namely, the allegation that Manufacturers relied on the fact that it had separate counsel to protect it from conflict. As we have noted, Manufacturers had always had different counsel on the New Haven trust and on the Central trusts for historic reasons, which long predated and had nothing to do with what happened in June 1970. While this fact facilitated the course of conduct Manufacturers felt compelled to pursue, it was not the critical determinant of Manufacturers' actions. As we have noted, it was regard for its fiduciary obligations to *all* of its *cestuis* which dictated Manufacturers' course of conduct.

course, neither the New Haven nor Manufacturers had any control whatsoever, Manufacturers thereupon forfeited any claim to compensation or reimbursement in connection with its services past, present or future, unless, instead of seeking to pursue diligently an orderly transition, it immediately tossed aside all of its responsibilities under its Central trusts.

When the underbrush is penetrated, what Appellants seem really to be contending for is a drastic penalty against Manufacturers and its counsel, robbing them of the admitted value of past services because Manufacturers still continues to act as Trustee under a number of Central mortgages from which it has not been able to resign because of problems in the Penn-Central reorganization unrelated to their past services to the New Haven. Such a concept disregards basic principles of trust law[17] and leads to a most unfair result. While the Reorganization Court accepted an analysis of the facts predicated on this "continuing conflict" theory, it rejected the implication Appellants would read into this conclusion, and, exercising its proper discretion, rejected a result so obnoxious to equitable principles.

There Was No Abuse of Discretion by the Reorganization Court

Appellants would have this Court hold that under the circumstances present here, although the Reorganization Court has explicitly recognized the just value of the services rendered by Manufacturers and its counsel and has found that they furthered the Debtor's reorganization

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[17] Absent use of confidential information or overreaching, once a trustee has resigned from a trust, his fiduciary obligations to the trust cease and he may thereafter deal with his former *cestuis* in the normal course of business. See II *Scott on Trusts* § 170.8 (3d Ed. 1967); *Restatement (Second) of Trusts* § 170, comment g (1959).

(A507, 516-520), Judge Anderson was nevertheless required *as a matter of law* to deny all compensation once he found a technical conflict, regardless of its character.

Appellants seek to support this inequitable conclusion by resorting to their so-called "*Woods-Wolf* doctrine", an amalgam of *Woods* v. *City National Bank and Trust Co.*, 312 U.S. 262 (1941) and *Wolf* v. *Weinstein*, 372 U.S. 633 (1963). This result, we submit, must be rejected because there is no such doctrine. These two cases are entirely unrelated and cannot be homogenized.

Woods recognizes and affirms the inherent discretionary authority of a reorganization court to allow or disallow compensation for services and reimbursement for expenses of trustees, having due regard for the individual circumstances. *Wolf*, on the other hand, was controlled by Section 249 of the Bankruptcy Act, an absolute statutory command of Congress which overrode the traditional discretion of the court in a single specific context, viz., trading in the securities of a bankrupt by those owing it fiduciary obligations.[18]

The Supreme Court held in *Woods*, a case of blatant self-dealing by fiduciaries (and their counsel) which in fact injured their *cestuis*, that a bankruptcy court *might*, in its discretion, deny compensation to a fiduciary who has breached his fiduciary duties under such circumstances.[19] While

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[18] Instructively, Section 249 "had common origins and parallel purposes" to the insider trading provisions of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78p(b). See *Wolf* v. *Weinstein*, *supra*, 372 U.S. at 643, fn. 11.

[19] In *Woods*, claims for compensation were filed by an indenture trustee, the members of a bondholders' committee, and the committee's counsel. The bondholders' committee, originally organized by the indenture trustee, included employees of the indenture trustee's corporate reorganization department as well as employees of an underwriter heavily interested in the debtor's stock and under threat of suit for defrauding the bondholders. The same firm of

Woods states that "[w]here a claimant, who represented members of the investing public, was serving more than one master or was subject to conflicting interests, he should be denied compensation", 312 U.S. at 268, *Woods* in no way stands for the proposition for which Appellants ask this Court to read it, namely, that a reorganization court *must* deny compensation once it finds a conflict. The Supreme Court in *Woods* was reviewing a decision of the Seventh Circuit which overruled a district court's exercise of its discretion to deny compensation to the claimants. The Supreme Court wrote:

> "We granted the petition for writs of certiorari in view of the importance in reorganization proceedings of the power of the District Court over such allowances." (footnote omitted) 312 U.S. at 264.

The Supreme Court stated further:

> "Under Ch. X of the Chandler Act the bankruptcy court has plenary power to review all fees and expenses in connection with the reorganization from whatever source they may be payable." (footnote omitted) 312 U.S. at 267.

It reversed the Seventh Circuit, holding that the District Court findings "are amply supported by the evidence." 312 U.S. at 269. As the Supreme Court has subsequently noted:

> ". . . *Woods* v. *City Bank Co.*, 312 U.S. 262, held only that a bankruptcy court, in the exercise of its

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attorneys retained by the indenture trustee were employed by the committee. Thus the interlocking personnel of the committee and the indenture trustee represented the depositing bondholders who were interested in having a low upset price fixed for the debtor's property, the non-depositing bondholders who were interested in a high upset price, and a large stockholder who sought a favorable position in the reorganization at the expense of both. That egregiously improper swamp of conflicting interests bears no resemblance to the open and selfless conduct with which Judge Anderson dealt here.

> plenary power to review fees and expenses in connection with a reorganization proceeding under Chapter X of the Chandler Act, 52 Stat. 840, *could* deny compensation to protective committees representing conflicting interests." *SEC* v. *Chenery Corp.*, 318 U.S. 80, 89 (1943) (Emphasis added.)[20]

As noted above, the Supreme Court recognized in *Wolf* that, in Section 249 of the Bankruptcy Act, it was confronted with a Congressional command, absolute and unconditional in its terms, intended to displace the discretionary powers of a bankruptcy court in favor of a specific forfeiture rule dealing with one specific form of self-interest, namely, insider trading. *Wolf* dealt with the question whether an officer and a general manager of a debtor in possession, who had made small purchases and sales of the company's securities, were fiduciaries within the meaning of Section 249. Holding that they were fiduciaries, and therefore denying all compensation in accordance with the statute's command, the Court stated, "that the rule occasionally bars compensation to those whose conduct might not have been considered inequitable or disloyal in the absence of [Section 249] is no reason to suspend or make selective the operation of the statute's sanctions." 372 U.S. at 655-56.

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[20] Appellants' efforts (App. Brief, pp. 23-24) to construe the language of *Woods*, which recognizes a reorganization court's discretionary power to allow reimbursement for "proper costs and expenses incurred in connection with the administration" of an estate as counselling even against reimbursement of Manufacturers' expenses, ignores the facts and is not supported by the law. Appellants understand (see App. Brief, pp. 15-16) precisely what expenses Manufacturers has claimed here, principally, the cost of printing briefs and appendices and purchasing transcripts (in proceedings before the ICC, the Reorganization Court, the Three-Judge Court, and the Supreme Court) and Manufacturers' share of the fees of expert witnesses and consultants who were hired in connection with the Bondholders' case before the ICC and the Reorganization Court. Appellants' attempt to invoke *Wolf's* application of Section 249 standards to deny reimbursement of these expenses illustrates the error of their analysis.

This Court and the Seventh Circuit have recognized that, upon finding a conflict of interest, the bankruptcy court has power, in the exercise of its discretion, and having regard to the circumstances and the nature of the fiduciary's conduct, to tailor its remedy by granting, modifying, reducing or, in appropriate cases, even denying compensation. *Berner* v. *Equitable Office Bldg. Corp.*, 175 F.2d 218 (2d Cir. 1949); *Silbiger* v. *Prudence Bonds Corp.*, 180 F.2d 917 (2d Cir.), *cert. denied*, 340 U.S. 813 (1950); *Chicago & West Towns Rys.* v. *Friedman*, 230 F.2d 364 (7th Cir.), *cert. denied*, 351 U.S. 943 (1956). See also *In re Ritz Carlton Restaurant & Hotel Co.*, 60 F. Supp. 861 (D.N.J. 1945), and *In re American Acoustics Inc.*, 97 F. Supp. 586 (D.N.J.), *aff'd*, 192 F.2d 81 (3rd Cir. 1951), where the District Court, in the exercise of its discretion, denied compensation on general equitable principles, finding a conflict that significantly contaminated the trustee's conduct *throughout* his trusteeship.

This Court specifically held in *Berner* v. *Equitable Office Bldg. Corp., supra*, 175 F.2d at 222:

> "[S]ince Congress [in enacting Section 249] limited the penalty of entire forfeiture to purchases by a fiduciary, we should not be warranted in extending that penalty to the situation at bar; and we think that the consequences should be only those which attend any breach of trust in equity: i.e., that in determining what the trustee's compensation shall be, the court will, as a matter of discretion diminish the allowance which it would otherwise make, in proportion to the gravity of the breach." (footnote omitted)

Judge L. Hand proceeded to analyze a series of allegations of impropriety, emphasizing that the District Court

was empowered to weigh the equities and to rule upon allowance petitions as a matter of discretion.

Appellants cite *Surface Transit Inc.* v. *Saxe, Bacon & O'Shea,* 266 F.2d 862 (2d Cir. 1959), as standing for the proposition that "[t]he discretionary approach of *Berner* may no longer be the law of this Circuit" (App. Brief, p. 22). This assertion misreads *Surface Transit.* This Court's concern in *Surface Transit* was with *Berner*'s treatment of insider trading by family members. This Court did not say that *Berner* was in error, but that:

> "The language of [*Berner*] . . . and Nichols v. SEC, 2 Cir., 211 F.2d 412, 416-417 [which deal with imputing transactions by family members to the fiduciary], on which the court below relied, is perhaps broader than those decisions warrant. Each case is clearly distinguishable on its facts from the instant situation; and on the reasoning of the above cited decisions we hold that [the attorney's] firm is disqualified from compensation *by the* [*insider trading*[21]] *transaction here complained of.*" 266 F.2d at 868 (Emphasis supplied.)[22]

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[21] I.e., a violation of Section 249.

[22] Appellants' reliance (App. Brief, pp. 29-31, 37) on *Mosser* v. *Darrow,* 341 U.S. 267 (1951), is similarly misplaced. They ignore the fact that *Mosser* was not an allowance case but a self-dealing case. The Court held in *Mosser* that a bankruptcy trustee—who had authorized and failed to disclose a conflict of interest between his employees and the bankrupts—could be surcharged for the employees' profits. The trustee employed two assistants in managing bankrupt holding companies on terms which permitted those employees to trade for their own profit in the securities of the companies at the same time as the trustee was purchasing them. The trustee made no disclosure of this agreement. "Indeed, it appears that he did not even disclose this feature of the transaction to his own counsel." 341 U.S. at 274. The *Mosser* case clearly does not require the unfair result which Appellants ask this Court to impose, in derogation of Judge Anderson's meticulous exercise of discretion on his interpretation of the facts, an interpretation with which we have already noted our limited disagreement.

In the instant situation the Section 249 cases are inapposite and, therefore, Appellants' *"Woods-Wolf"* synthetic theory must fail. Absent abuse of discretion, and none has been shown, this Court should sustain the Reorganization Court's determination as reasonable in all the circumstances and well within the power and discretion of Judge Anderson.

Conclusion

By reason of the foregoing, we submit that the Reorganization Court did not abuse its discretion by its disposition of the application for allowance of fees and disbursements of Manufacturers. The inequitable result sought by Appellants and rejected below, should be rejected here.

Respectfully submitted,

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STATE OF NEW YORK)
: ss.:
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DAVID A. BOILLOT, being duly sworn, deposes and says:

I am an attorney associated with Simpson Thacher & Bartlett, attorneys for Appellee, Manufacturers Hanover Trust Company, am over the age of eighteen (18) years and am not a party to this action.

On the 20th day of December, 1976, I served a copy of the annexed Answering Brief of Appellee, Manufacturers Hanover Trust Company, upon the parties set forth in the attached list by depositing two (2) copies [illegible] properly addressed postpaid wrapper in a regularly maintained official depository under the exclusive care and custody of the United States Post Office Department located in the City, County and State of New York.

David A. Boillot
David A. Boillot

Sworn to before me this
20th day of December, 1976.

Kathleen E. Shoos
Notary Public

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